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A tall order for the “new kid on the block”—the forthcoming market investigation reference in the energy market will keep the CMA busy from the start!

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The energy market has been at the forefront of the political, legal and media debate for a considerable time: concerns at high prices, “suspicious” market transparency and a considerable degree of concentration have characterised the retail market segment of the industry (see e.g. <http://www.bbc.co.uk/news/business-26734203>). In addition, the trend toward significant vertical integration, with the “big six” active in the generation and wholesale as well as in the retail supply side of these markets have increasingly been regarded as a factor contributing to the opacity of prices and profits. Undoubtedly the last year or so has seen more customers switching suppliers; however, at the same time more complaints against energy companies have been lodged, many of which concerned the lack of clarity as to energy prices. The main energy suppliers have been repeatedly accused of limiting the best deals to new customers and to apply significantly higher tariffs to their existing ones (see inter alia <http://www.bbc.co.uk/news/business-24238708>). More generally, despite the efforts on the part of OFGEM to inject greater transparency in the area of billing, consumer organisations continue to denounce that customers find bills confusing and as a result, according to a very recent Which? survey, only 35% of the adults surveyed are able to identify the “best deal” (see <http://www.bbc.co.uk/news/business-26566667>).

Against this background, it is not surprising that OFGEM announced today its decision to refer the energy market to the Competition and Markets Authority for an investigation. The CMA will become officially operative, replacing the OFT and the Competition Commission and working closely in partnership with sector regulators through the UK competition network on the 1st of April; this reference is therefore going to offer it a prime opportunity to act upon one of its strategic priorities, namely to promote strong and fair competition in all markets, including regulated ones, so that consumers can feel “empowered, confident and able to exercise informed choice” (see CMA, Vision and Values Strategy document, available at: https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/274059/CMA13_Vision_and_Values_Strategy.pdf, p. 1).

So, what are the live issues that the CMA may wish to consider in its Market Investigation?

In an interview with BBC Breakfast (for an extract see: <http://www.bbc.co.uk/news/business-26734203>), the OFGEM Chief Executive, Brendon Nolan, was very clear in saying that no evidence of cartel behaviour had been established so far. However, the OFGEM report highlights the big six’s practice of regular price announcements, taking place more or less at the same time and likely to be followed by price increases: while announcing prices may, to an extent, be justified in light of the characteristics of the industry, it can also act as a “signal” for competitors who may then choose to replace healthy competitive pressure on fellow rivals with the “quiet life” of coordinated behaviour (see chapter 4 of the report). The challenge for the CMA, therefore, seems to be in assessing the extent to which this may amount to conscious parallelism which, without going as far as to meet the ‘concurrence of wills’ requirement, characterising an ‘agreement’, can be regarded as a concerted practice.

Vertical integration is also singled out as a challenge for the competitiveness of the energy market; the OFGEM report

vertical integration is also singled out as a challenge for the competitiveness of the energy markets: the OFGEM report (available at: <https://www.ofgem.gov.uk/ofgem-publications/86804/assessmentdocumentpublished.pdf>) emphasised that the fact that the big players are active not only on the retail but also on the wholesale/generation market for energy is liable to represent one of the explanations of the weak position of smaller players on the customer segment, thus preventing them to reach a greater slice of retail demand (see chapter 5 of the Report). In addition, trading in energy at wholesale level has proven to be opaque and any revenues accruing to the big six from this activity difficult to “decouple” from retail profits (see chapter 6 of the report). In light of the forgoing, it may legitimately be queried whether allowing the more powerful companies, including a former statutory incumbent, to act on both market segments may represent an obstacle for entry as well as for the expansion of smaller firms: in this respect, it may be especially probed whether evidence of margin-squeeze type behaviour could be gathered from the market investigation. The ostensible difficulties in identifying and separating out revenues from retail and generation activities has also complicated the picture in respect of energy prices and the calculation and actual appraisal of profits: OFGEM pointed out that while profits have increased there is no clear evidence that operating costs have gone down (see chapter 6 of the Report, especially pp. 100-110). Accordingly, it can be questioned whether the big six suppliers may have achieved this outcome by cross-subsidising between the two market segments: while the evidence is not sufficient to found a conclusion that these profits may be excessive (see Summary of the Report’s market outcomes, sections 1.6-1.8) it could be interpreted as an indication of the ability of the major suppliers, shielded from significant pressure from the other 18 small rivals, to “hedge” their returns thanks to their ability to rely on the supply of power that they themselves generate. This, however, is also liable to have an adverse impact on non-integrated competitors, who not only have to put out significant capital in order to trade on the wholesale market, but are also dependent on their very rivals on the retail market (see Summary, sections 1.30-1.34).

Overall, the OFGEM report paints a bleak picture indeed for the energy industry: weak competition with a trend toward conscious parallelism; high barriers to entry, much of which derive from the vertically integrated nature of these markets (especially the one for electricity); low consumer confidence, based on the evidence of high profits coupled with the opacity of cost and pricing structures. All of these outcomes are likely to provide a lot to think about for the CMA. However, there is much to be gained in dealing with this industry quickly and effectively: energy expenditure is a key figure in family and industry budgets (especially for SMEs). The MIR in the energy markets represents certainly a challenge but also brings opportunity, namely, the opportunity of truly empowering consumers to make informed choices in their purchases: it is therefore in the interest of the economy and of society as a whole to identify the drivers that may cause consumer harm in these markets. Holding the big six to account, especially by making their cost, profit and pricing structure clearer is also likely to increase the switching rate in a more sustained way overtime.

In its Vision and Values Strategy document the CMA expressed a clear commitment toward “using the market regime to improve the way competition works where evidence shows it can most benefit consumers” (https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/274059/CMA13_Vision_and_Values_Strp.1-2). The energy market investigation reference is definitely likely to test its willingness to do just this.

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